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IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

COMMUNICATIONS SATELLITE CORPORATION,
Appellant,
vs.
FRANCHISE TAX BOARD,
Appellee.

On Appeal From the Court of Appeal of the State of California for the First Appellate District

JURISDICTIONAL STATEMENT

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QUESTION PRESENTED

California computes the net income of a multistate corporation attributable to California for income tax purposes by means of the standard statutory three-factor apportionment formula, based upon the proportion of the corporation's in-state property, payroll and sales to its total property, payroll and sales.

The question presented is whether California has apportioned out-of-state income to itself, in violation of the Due Process, Commerce and Equal Protection Clauses of the United States Constitution, by discarding the standard formula and applying to Comsat's communications satellite income a unique special formula which includes:

1. As California property, satellites permanently located in outer space;
2. As California sales, revenue from those satellites; and
3. As California sales, additional revenue derived outside California from Comsat's share of the global system of satellites and ground control facilities located in other jurisdictions.

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
OPINIONS BELOW	1
JURISDICTION	2
CONSTITUTIONAL AND STATUTORY PROVISIONS	2
STATEMENT OF THE CASE	2
THE QUESTIONS PRESENTED ARE SUBSTANTIAL: THE DECISION BELOW EXPANDS A STATE'S TAXING POWERS BEYOND ITS BORDERS AND INTO OUTER SPACE IN CONFLICT WITH THIS COURT'S DECISIONS	11
A. The decision below denies Comsat due process of law	12
B. The decision below works an unconstitutional burden on interstate and foreign commerce	18
C. The decision below denies Comsat equal protection of the laws	20
CONCLUSION	21

TABLE OF AUTHORITIES CITED

Cases

	Page
ALLIED STORES OF OHIO v. BOWERS, 358 U.S. 522 (1959)	20
ARMCO INC. v. HARDESTY, ____ U.S. ____, 104 S.CT. 2620 (1984)	18
ASARCO, INC. v. IDAHO STATE TAX COMM'N, 458 U.S. 307 (1982)	12, 16
COMMONWEALTH EDISON CO. v. MONTANA, 453 U.S. 609 (1981)	19
COMPLETE AUTO TRANSIT, INC. v. BRADY, 430 U.S. 274 (1977)	18, 19
CONNECTICUT GENERAL LIFE INSURANCE CO. v. JOHNSON, 303 U.S. 77 (1938)	12
CONTAINER CORP. v. FRANCHISE TAX BOARD, ____ U.S. ____, 103 S.CT. 2933 (1983)	13, 14, 15, 16, 18
EXXON CORP. v. WISCONSIN DEPT. OF REVENUE, 447 U.S. 207 (1980)	14, 15
F. S. ROYSTER GUANO CO. v. VIRGINIA, 253 U.S. 412 (1920)	20
HANS REES' SONS, INC. v. NORTH CAROLINA, 283 U.S. 123 (1931)	15, 16
MINNEAPOLIS STAR & TRIBUNE CO. v. MINNESOTA COMMISSIONER OF REVENUE, ____ U.S. ____, 103 S.CT. 1365 (1983)	21
MOBIL OIL CORP. v. COMMISSIONER OF TAXES, 445 U.S. 425 (1980)	16
NORFOLK & WESTERN R. CO. v. MISSOURI STATE TAX COMM'N, 390 U.S. 317 (1968)	12
WESTERN & SOUTHERN LIFE INS. CO. v. STATE BOARD OF EQUALIZATION, 451 U.S. 648 (1981)	20
WISCONSIN v. J.C. PENNEY CO., 311 U.S. 435 (1940)	19

TABLE OF AUTHORITIES CITED

CONSTITUTION

PAGE

UNITED STATES CONSTITUTION:
COMMERCE CLAUSE (ART. I, §8, CL. 3) ..... *PASSIM*
DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT ..... *PASSIM*
EQUAL PROTECTION CLAUSE OF THE FOURTEENTH AMENDMENT ..... *PASSIM*

STATUTES

CALIFORNIA REVENUE AND TAXATION CODE:
§25101 ..... 2, 6, 17
§25120-25139 ..... 2, 5, 10, 14, 16
§25137 ..... 2, 7
COMMUNICATIONS SATELLITE ACT OF 1962 (47 U.S.C. §701 et. seq.) 2
28 U.S.C. §1257(2) 2

Regulations

CALIFORNIA FRANCHISE TAX BOARD REGULATION 25136 ..... 6, 7, 14, 20

Rule

SUPREME COURT RULE 28.1 2

No. 84-___

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COMMUNICATIONS SATELLITE CORPORATION,
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On Appeal From the Court of Appeal of the State of California for the First Appellate District

JURISDICTIONAL STATEMENT

OPINIONS BELOW

The findings of fact, conclusions of law, and the judgment of the Superior Court of the State of California, granting judgment in favor of Communications Satellite Corporation ("Comsat") (App. B, *infra*, A-38 to A-47) are not officially reported. The opinion of the Court of Appeal reversing the

judgment of the Superior Court (App. A, *infra*, A-1 to A-37) is reported at 156 Cal. App. 3d 726, 203 Cal. Rptr. 779.

JURISDICTION

The Court of Appeal rendered its opinion and judgment on May 31, 1984. Comsat's petition for rehearing was filed June 14, 1984, and was denied by the Court of Appeal on June 29, 1984, but with a modification of the Court's opinion. (App. D, *infra*, A-49 to A-50.) Comsat's petition for hearing in the California Supreme Court was filed July 3, 1984, and was denied August 29, 1984. (App. E, *infra*, A-51.)

A notice of appeal was filed in the Court of Appeal on October 15, 1984 (App. F, *infra*, A-52 to A-53). By order dated November 21, 1984, Justice Rehnquist extended the time within which to docket the appeal to and including December 26, 1984. The jurisdiction of this Court rests upon 28 U.S.C. §1257(2).

CONSTITUTIONAL AND STATUTORY PROVISIONS

The relevant provisions of the Constitution are the Commerce Clause (Art. I, §8, cl.3) and the Due Process Clause and Equal Protection Clause of the Fourteenth Amendment. The relevant provisions of the California Revenue and Taxation Code are sections 25101, 25128, 25129, 25134 and 25137. These provisions are all included in App. G, *infra*, A-54 to 55.

STATEMENT OF THE CASE

Comsat is a District of Columbia corporation established by Congress pursuant to the Communications Satellite Act of 1962 (47 U.S.C. § 701 *et seq.*).[1] Under section 401 of the Act (47 U.S.C. § 741), Comsat is regulated as a communications common carrier by the Federal Communications Commission ("FCC"). Comsat represents the United States in the Interna-

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[1] Comsat has no parent company. Pursuant to Rule 28.1, Comsat's non-100 percent-owned subsidiaries and affiliates are set forth at App. C, *infra*, A-48.

tional Telecommunications Satellite Consortium ("Intelsat"). Intelsat is an organization established in 1964 by international agreements to operate the space segment (satellites and related ground tracking and control facilities) of the global commercial communications satellite system (Stip. ¶¶ 1, 3-5; App. A, *infra*, A-1, A-3).[2]

Comsat engages in two types of operations relevant to this constitutional challenge to the imposition of California income taxes on Comsat's revenues earned outside California. First, Comsat earns revenue by leasing half-circuits between its earth stations and Intelsat satellites to communications common carriers. Second, Comsat earns revenue from its share of income derived by Intelsat from the lease of satellite capacity. (For convenience, we refer to these operations as "Comsat Operations" and "Intelsat Operations" respectively).

1. Comsat Operations. Comsat's headquarters and laboratory are located in the Washington, D.C. area (App. A, *infra*, A-2; App. B, *infra*, A-38). Comsat earns the greater part of its revenue from leasing half-circuits between the eight Comsat earth stations and Intelsat satellites to communications common carriers. An earth station is a facility with large antennae and supporting electronic equipment. A half-circuit is a two-way communications channel between an earth station and a satellite. The connecting half-circuit between the satellite and another earth station completes the circuit between the two earth stations (Stip. ¶¶ 14, 19; App. A, *infra*, A-5).

The satellites and other space segment assets are owned in varying percentages in undivided shares by the members of Intelsat, including Comsat (App. A, *infra*, A-4). Intelsat satel-

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[2] "Stip." refers to paragraphs of the extensive Stipulation of Facts describing Comsat's operations and activities. The Stipulation of Facts is found in the Clerk's Transcript on Appeal at 10-32. For the convenience of the Court, Comsat will lodge a copy of the Stipulation of Facts with the Clerk when this Jurisdictional Statement is filed.

lites relay all forms of telecommunications (including telephone, television, teletype and data transmissions) between earth stations located in various countries. The satellites are monitored and controlled through Intelsat tracking stations located in Maine, Hawaii, Italy and Australia. The satellites are launched from Cape Canaveral, Florida and are permanently located in outer space in "synchronous orbit"[3] 22,300 miles over fixed points on the Equator, above the Atlantic, Pacific and Indian Oceans. They never pass over California, even during launch, and their orbital position over the earth is never over California. (Stip. ¶¶ 8, 9).

Comsat owns a 50% interest in an earth station located in Jamesburg, California. (Stip. ¶ 17; App. A, *infra*, A-5). The location of the earth station in California is not required for any technical or business reason. An earth station located in Brewster, Washington also carries Pacific Ocean traffic, and a station capable of performing the same functions could be located in another western state (Stip. ¶ 28). The California earth station communicates only with the Pacific Ocean satellite (Stip. ¶ 23; App. A, *infra*, A-6). Comsat conducts no sales or marketing activities in California and has no particular market in California. (Rep. Tr. 36-37, 60-64; App B, *infra*, A-40.)

The California earth station, which is used solely in interstate and foreign commerce, operates as follows:

> 1. A communications signal destined for an offshore U.S. point or a foreign country is received by the California earth station from its place of origin in the United States through terrestrial facilities (telephone lines, microwave relay systems, etc.) owned and operated by communications common carriers other than Comsat.

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[3] A synchronous orbit is one in which the orbital speed of the satellite is synchronized with the speed of the earth's rotation, so that the satellite appears to remain stationary over a fixed point on earth (Stip. ¶ 8, App. A., *infra*, A-4).

2. The earth station continues transmission of the signal to an Intelsat satellite in orbit, which in turn continues its transmission to an earth station at an offshore U.S. point or a foreign country.

3. Conversely, communications from offshore U.S. points and foreign countries are received via satellite by the California earth station which similarly continues their transmission to points of destination elsewhere in the United States. (Stip. ¶ 24; App. A, *infra*, A-6.)

Comsat leases the half-circuits to its customers under a tariff filed with the FCC. The tariff covers use of both an earth station and a satellite, with no breakdown between the two elements. The rates Comsat charges are regulated by the FCC according to the traditional rate base method of regulation. Comsat is permitted to make charges designed, but not guaranteed, to generate revenues sufficient to cover its operating expenses (including taxes and depreciation) and provide a fair rate of return on its rate base. The rate base consists chiefly of Comsat's investment in property devoted to the regulated business. (Stip. ¶¶ 14, 31, 33; App. A, *infra*, A-7).

2. Intelsat Operations. The revenues of Intelsat are derived solely from use charges paid by members of Intelsat, including Comsat, for use of the space segment facilities which are located entirely outside of California. Intelsat has no employees or property in California (Stip. ¶ 12). During the years at issue (1970-1972), Comsat received 52.5% of Intelsat's gross revenues, as a result of its 52.5% ownership interest in the space segment. (Stip. ¶ 34; App. A, *infra*, A-7).

3. The Statutory Tax Computation. California has substantially adopted the Uniform Division of Income for Tax Purposes Act ("UDITPA"). The Act provides the familiar three-factor formula (property, payroll and sales) for apportionment for tax purposes of income of a corporation which derives its income from within and without the state. (California Revenue & Taxation Code §§ 25120-25139). Under the formula, the taxpayer computes its income apportionable to California by mul-

tiplying its total net business income by a fraction representing the average ratio of its California property, payroll and sales to its total property, payroll and sales. The State then levies franchise or income tax upon the resulting amount—"the net income derived from or attributable to sources within this state." (California Revenue & Taxation Code § 25101).

Comsat computed its tax liability by the statutory formula for the years at issue (1970-72). Comsat therefore included in the numerator of its property factor all of its California property (primarily its one-half interest in the California earth station) and included in the denominator the total value of its property. Comsat did not include in the California property numerator any of its individual share of the satellite property owned by Intelsat because this property was located in outer space. (Stip. ¶ 43).

Similarly, in computing the statutory sales factor, Comsat included in the numerator its California sales revenue and included in the denominator its total sales revenue. In measuring its California sales revenue, Comsat included only that portion of its half-circuit rental revenue attributable to the lease of the use of the California earth station, and other minor California revenue. Comsat did not, however, include in the California sales numerator either revenue attributable to the lease of the use of a satellite or its share of revenue received by Intelsat for leasing space segment capacity. (Stip. ¶ 47). In excluding this revenue from the sales numerator, Comsat relied upon a California Franchise Tax Board Regulation which explicitly provided that rental income was assigned to the state only to the extent that the leased property "was physically present" in the state.[4]

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[4] The Regulation (California Franchise Tax Board Regulation 25136) provided in part as follows:

(B) Gross receipts from the rental, lease, licensing the use of or other use of tangible personal property shall be assigned to this state if the property is

[continued next page]

4. The Franchise Tax Board's Special Formula Computation. The California Franchise Tax Board ("the Board") asserted that "the allocation and apportionment provisions of [the three-factor formula did not] fairly represent the extent of [Comsat's] business activity in [California]."[5] It thereupon recomputed the portion of Comsat's income apportioned to California by devising a "special formula" wholly different from the statutory three-factor formula.

The Board's special formula added to the statutory property factor numerator as California property part of Comsat's interest in the Intelsat satellites in outer space. The increment was computed as follows (Stip. ¶ 57):

$$\left\{\frac{\text{Original cost of California property}}{\text{Original cost of all property except satellites}}\right\} \times \left\{\text{Original cost of satellites}\right\} = \left\{\text{Value of satellites to be apportioned to California}\right\}$$

The Board made comparable adjustments to Comsat's sales factor. For each of the years in question, the Board added to the

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within this state during the entire period of rental, lease, license or other use. If the property is within and without this state during such period, gross receipts attributable to this state shall be based upon the ratio which the time the property was physically present or was used in this state bears to the total time or use of the property everywhere during such period.

[5] The Board relied upon California Revenue & Taxation Code § 25137(d) which reads:

> If the allocation and apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the Franchise Tax Board may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
>
> . . .
>
> (d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

statutory sales factor numerator as California sales revenue a portion of Comsat's revenue from Intelsat and a portion of Comsat's revenue from rental of half-circuits attributable to the satellites. The formula used by the Board in computing the numerator was as follows (Stip. ¶¶ 60, 61):

$$\left\{\begin{array}{l}\text{Number of half-circuits leased at the California earth station} \\ \hline \text{Number of half-circuits leased by Comsat at all earth stations}\end{array}\right\} \times \left\{\begin{array}{l}\text{Earth Station Revenue} \\ + \\ \text{Space Segment Revenue} \\ + \\ \text{Intelsat Revenue}\end{array}\right\} = \left\{\begin{array}{l}\text{California} \\ \text{Revenue}\end{array}\right\}$$

The Board's adjustments to Comsat's statutory property and sales factors[6] resulted in sharp increases to the percentage of Comsat's income that was apportioned to California (App. A, *infra*, A-20 n.10):

Year	(1) Property Factor	(2) Payroll Factor (Undisputed)	(3) Sales Factor	Percentage of Income Apportioned to California (1) + (2) + (3) Divided by 3
1970				
Statutory	2.8296%	5.4991%	4.2414%	4.1900%
Board	4.9187%	5.4991%	16.4154%	8.9444%
1971				
Statutory	2.5464%	5.6544%	3.0098%	3.7369%
Board	4.8429%	5.6544%	16.4154%	8.9709%
1972				
Statutory	2.2114%	5.2305%	3.0039%	3.4819%
Board	4.8280%	5.2305%	16.4154%	8.8246%

The Board has admitted that Comsat is the only corporation to which the Board has sought to apply this special formula. (Board's Answers to Interrogatories 26 and 28 (Exhibit 2 at

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[6] There is no dispute over the computation of Comsat's payroll factor (the ratio of California payroll to all payroll).

trial).)[7] The special formula the Board applied represents its third position respecting apportionment of Comsat's income for the years in question.[8]

5. Proceedings Below. Comsat's protest against the increased tax assessment was rejected by the Board. After paying the resulting deficiencies,[9] Comsat brought this action for refund of excess taxes. Comsat's complaint alleged, *inter alia*, that the Due Process Clause and the Equal Protection Clause of the Fourteenth Amendment barred California's attempt to include satellites and revenue derived from satellites in California property and income. (Stip. ¶¶ 67-70).

After a trial, the Superior Court held that the Board had failed to carry its burden of proving that the statutory three-factor formula did "not fairly represent the extent of Comsat's business activity in California." The court overturned the Board's attempt to employ a special formula (App. B, *infra*, A-41), and entered judgment in favor of Comsat (*Id.* at A-46 to A-47). The trial court therefore had no reason to reach Comsat's

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[7] For the convenience of the Court, Comsat will lodge a copy of the Board's Answers to Interrogatories (Exhibit 2) with the Clerk when this Jurisdictional Statement is filed.

[8] After an audit, the Board first notified Comsat on August 27, 1974, that Comsat's returns for the years 1970-1972 would be accepted as filed. The Board next notified Comsat on November 20, 1974, that it was adjusting the apportionment factors by excluding the value of Comsat's interest in the Intelsat satellites from the denominator of the property factor and revising the sales factor to avoid the assignment of any of Comsat's revenue to non-taxing jurisdictions. By letter dated April 23, 1975, the Board notified Comsat that it had yet again revised the property factor to the special formula at issue here. The Board put the satellites back in the denominator but included a portion of satellite value in the numerator. (Stip. ¶¶ 53; 54; 56).

[9] The amounts at issue for 1970-72 (excluding interest) are: 1970–$28,307.65; 1971–$136,460.49; 1972–$151,576.76 (Stip. ¶ 68; App B, *infra*, A-44.). For all open years, Comsat estimates that the amounts at issue in California alone will exceed $10 million.

constitutional claims under the Due Process and Equal Protection Clauses.

The Court of Appeal reversed (App. A, *infra*, A-37). It rejected Comsat's claims under the Due Process, Equal Protection and Commerce Clauses[10] of the Constitution. The court held that Comsat "used" the satellites in California although the satellites were permanently located in outer space. As the Court of Appeal saw the matter, "There is an invisible, but apparently continuous and very real, connection between the earth station and the satellites" (App. A, *infra*, A-28). The court concluded that this "connection" justified the inclusion of the satellites in Comsat's property factor numerator as "tangible personal property owned . . . and used in this state" by Comsat within the meaning of section 25129 of the California Revenue and Taxation Code. (App. A, *infra*, A-29).

The Court of Appeal also upheld the Board's sales factor. The court recognized that "The 'income-producing activity' which generated [Comsat's satellite] revenue was the operation of the satellites themselves." (App. A, *infra*, A-32). It held however, that "because [the satellites] actually 'function' at the California earth station (as we have seen), their 'income-producing activity' is also 'performed in this state' . . ." (App. A, *infra*, A-32 to A-33). The California Supreme Court denied Comsat's petition for hearing. (App. E, *infra*, A-51).

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[10] Comsat raised the Commerce Clause violation in its petition for rehearing. The Court of Appeal considered and rejected it (App. D, *infra*, A-50).

THE QUESTIONS PRESENTED ARE SUBSTANTIAL: THE DECISION BELOW EXPANDS A STATE'S TAXING POWERS BEYOND ITS BORDERS AND INTO OUTER SPACE IN CONFLICT WITH THIS COURT'S DECISIONS

This case presents important questions of law which the Court of Appeal resolved in a manner conflicting with a long line of this Court's decisions prohibiting extraterritorial state taxation.

First: This case presents the question whether a state may, consistent with the Due Process Clause and Commerce Clause, expand its taxing powers to apportion to itself as net income from "sources within this state" income derived from commercial activity located in outer space. Previous decisions of this Court have established that states may not project their taxing power to activities located outside their borders. This Court should affirm that this settled principle likewise prohibits state taxation of commerce in outer space.

Second: This case presents the question whether a state may constitutionally substitute for the benchmark three-factor apportionment formula a special formula which attributes out-of-state property and sales to the state. The result is to apportion to California income that is grossly disproportionate to the business transacted by Comsat in California, in violation of both the Due Process Clause and Commerce Clause. Moreover, by discarding the statutory formula in favor of a special formula that it has concededly applied only to Comsat, California has singled out Comsat for particularly onerous tax treatment, and has thereby denied Comsat equal protection of the laws, in violation the Equal Protection Clause. The extreme result here, if allowed to stand, will encourage *ad hoc*, arbitrary and discriminatory application of state income tax laws.

A. The Decision Below Denies Comsat Due Process of Law

1. Although this case presents the question whether a state can include in its tax base property located in and revenue derived from activities in outer space, the operative Due Process principles were established by this Court long before the development of satellite technology. In *Connecticut General Life Insurance Co.* v. *Johnson*, 303 U.S. 77 (1938), the Court struck down on Due Process grounds a California tax on insurance premiums as applied to reinsurance contracts entered into outside California. The Court held (303 U.S. at 80-81):

> We look to the state power to control the objects of the tax as marking the boundaries of the power to lay it. Hence it is that a state which controls the property and activities within its boundaries of a foreign corporation admitted to do business there may tax them. But the due process clause denies to the state power to tax or regulate the corporation's property and activities elsewhere.

In *Norfolk & Western R. Co.* v. *Missouri State Tax Comm'n*, 390 U.S. 317, 325 (1968), the Court recognized these long standing principles:

> A State will not be permitted, under the shelter of an imprecise allocation formula or by ignoring the peculiarities of a given enterprise, to "project the taxing power of the state plainly beyond its borders." . . . Any formula used must bear a rational relationship, both on its face and in its application, to property values connected with the taxing State.

The "general principle" established by these many cases is that "a State may not tax value earned outside its borders". (*ASARCO, Inc.* v. *Idaho State Tax Commission*, 458 U.S. 307, 315 (1982), and cases cited therein). The same general principle prohibits California from applying any apportionment formula to Comsat which seeks to tax income derived from the satellites. There is no precedent which supports assigning property (and the revenue from it) permanently located outside a state to

that state for purposes of apportionment of income. The Board's special formula and the Court of Appeal's decision unconstitutionally extend California's taxing power beyond its borders—22,300 miles in outer space.

The California statutory formula employed by Comsat is the familiar three-factor computation "based, in equal parts, on the proportion of a unitary business's total payroll, property and sales which are located in the taxing State." *Container Corp. of America* v. *Franchise Tax Board*, ____ U.S. ____, 103 S.Ct. 2933, 2943 (1983). The three-factor formula "has become something of a benchmark against which other formulas are judged." *(ibid.)*. The Court recognized that, "The three-factor formula used by California has gained wide approval precisely because payroll, property, and sales appear in combination to reflect a very large share of the activities by which value is generated." (*id.* at 2949).

Because the taxpayer's total income is used as the multiplicand in the three-factor formula, the mathematical integrity of the formula demands that the numerators of the various fractions (property, payroll and sales) reflect in-state values with precision. If extraterritorial values are included as in-state values in the numerators, the formula will subject income to tax that does not have its source in the taxing state in violation of the Due Process Clause.

That is precisely what has occurred in this case. Here, California has discarded the benchmark three-factor statutory formula and has substituted in its place a special formula concededly designed to include Comsat's out-of-state property and sales in the numerator of its property and sales factors. This characterization of California's action is not a matter of debate or conjecture. To the contrary, it is squarely supported by the Board's own admissions in the trial court. In its answer to two separate interrogatories, the Board acknowledged that it included in Comsat's property and sales factors both property and income from property that was not located within the

state.[11] The special formula thus radically departs from the three-factor formula this Court approved in *Container Corp.*, because it was based upon factors "located in the taxing State".

There is, moreover, no basis for the Board's inclusion of Comsat's share of the revenue from Intelsat's operations in its California sales numerator. No act which produces Intelsat's revenue takes place in California to justify this extraterritorial taxation. Intelsat derives its revenue solely from the satellites and tracking and control facilities in which Comsat shares independent of any privilege or authority granted by California. There is not even the "'minimal connection' or 'nexus' between the interstate activities and the taxing State" which this Court has held is required by the Due Process Clause. *Exxon Corp.* v. *Wisconsin Dept. of Revenue*, 447 U.S. 207, 219 (1980). California has nevertheless apportioned to itself a share of Intelsat revenue from both satellites and tracking and control facilities—tangible property on the ground in Maine, Hawaii, Italy and Australia.

The Board's inclusion of what are unquestionably extraterritorial values in Comsat's property and sales factors results in

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[11] The Board's Answer to Interrogatory 3 (Exhibit 2 at trial) states:

> Section 25129 of the Revenue and Taxation Code provides that the numerator of the property factor is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state. The property factor employed by the Board to apportion plaintiff's income differs from the property factor described in section 25129 in that it includes property not located within the state, namely, a certain portion of the taxpayer's interest in communication satellites located in outer space.

The Board's answer to Interrogatory 8 (Exhibit 2 at trial) states in part:

> The sales factor employed by the Board to apportion plaintiff's income differs from the sales factor described in section 25134 and Regulation 25136(b)(2)(B) in that it includes receipts from the rental or other use of tangible personal property located outside the state, namely, a portion of the receipts from the leasing of Intelsat circuits, and a portion of half-circuit rentals attributable to the use of satellites located in outer space.

a formula skewed to apportion greater amounts of income to California. In these circumstances, the constitutional integrity of the special formula is irreparably compromised because the factors no longer "reflect a reasonable sense of how income is generated." *Container Corp., supra*, at 2942.

2. An apportionment formula which produces a result grossly out of proportion to the taxpayer's business and property values in the state violates the Due Process Clause. In *Exxon Corp.* v. *Wisconsin Dept. of Revenue, supra*, at 207, 219-220, the Court said "The tax cannot be 'out of all appropriate proportion to the business transacted by the appellant in that State.'" [Citation omitted.]

In *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U.S. 123 (1931), the statutory single factor (property) formula used by North Carolina apportioned approximately 85% of the taxpayer's net income to North Carolina, despite the taxpayer's evidence that its manufacturing activities in North Carolina produced only about 17% of its total income. This Court found the resulting gross discrepancy constitutionally infirm, concluding (283 U.S. at 135-36):

> The statutory method . . . operated unreasonably and arbitrarily, in attributing to North Carolina a percentage of income out of all appropriate proportion to the business transacted by the appellant in that State. In this view, the taxes as laid were beyond the State's authority.

In approving the standard three-factor formula, this Court recently reaffirmed the principle set down in *Hans Rees' Sons, Inc.* that the gross distortion of income attributed to a taxing state is not constitutionally permissible. This Court stated in *Container Corp., supra* 103 S.Ct. at 2949:

> The three-factor formula used by California has gained wide approval precisely because payroll, property, and sales appear in combination to reflect a very large share of the activities by which value is generated. It is therefore

able to avoid the sort of distortions that were present in *Hans Rees' Sons, Inc.*

The theory of the three-factor formula thus is that by determining the extent to which these income-generating factors are located in a particular state the income of the unitary business can be fairly apportioned to that state. UDITPA provides in detail the methods to be used in determining where the factors are located. *See* California Revenue & Taxation Code §§ 25120-25139.

In *Container Corp.*, the Court found a 14% discrepancy between the taxpayer's result and the Board's result to be less than a constitutionally infirm disproportion in contrast to "the more than 250% difference which led us to strike down the state tax in *Hans Rees' Sons, Inc.*" (*supra* 103 S.Ct at 2950). Here, the special formula apportionment percentages *are* in the range of 250% greater than the standard three-factor formula apportionment percentages (213%, 240% and 253%) for the three years at issue.[12] These gross discrepancies cannot pass muster under the Due Process Clause, which requires a "rational relationship between the income attributed to the State and the intra-state values of the enterprise." *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425, 437 (1980). These gross discrepancies demonstrate that California is taxing "value earned outside its borders" (*ASARCO, Inc.*), that the resulting tax is "out of all appropriate proportion" (*Hans Rees' Sons, Inc.*) to the business transacted by Comsat in California, and that the special formula extends California's taxing power beyond the factors "which are located in the taxing State" (*Container Corp.*) by which it may constitutionally measure its income tax.

3. The court below sought to justify the special formula applied by the Board on the basis of an "invisible connection"

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[12] These percentage discrepancies are computed by comparing the difference between Comsat's statutory formula percentages and the Board's special formula percentages. See p. 8 *supra*.

between the earth station and the satellites. (App. A, *infra*, A-28). The court concluded that this "connection" supported the inclusion of the satellites as "tangible personal property owned . . . and used in [California]" (*id.* at A-29) and the revenue from the satellites as sales within the state (*id.* at A-33).

But the relationship between the earth station and the satellites invoked by the court below does not bring the satellites within the taxing jurisdiction of California for purposes of the Due Process Clause. The relationship is relevant only to establish that the satellites and earth stations are both part of a unitary business, a fact Comsat has never contested. All of Comsat's unitary income is conceded here to be subject to apportionment. Whatever "connection" may be said to exist between the California earth station and the satellites has already been taken into account by the formula which subjects all of Comsat's unitary business income to apportionment by the constitutionally appropriate fraction. The purported "invisible connection" may not be taken into account again by including out-of-state property and sales in the in-state numerators of the formula.

The Court of Appeal's application of California Revenue & Taxation Code §25101 has vast implications in the field of telecommunications and beyond. The purported "invisible connection" between the California earth station and the satellites in outer space would continue through the California earth station and end only with the originators or recipients of telephone calls or other communications, usually outside of California. Under the court's theory, all telephone, teletype, data, television and other communications equipment used in transmissions through the California earth station would "function in California" and be "used" there. California could, under the court's view, properly tax the income generated by telecommunications equipment located outside California, as well as other equipment such as computers, which communicate with facilities in California. The rationale that the court below applied to

satellites in outer space would be equally applicable to a microwave tower in Oregon communicating with California. Indeed, as this case demonstrates, California has already carried its "invisible connection" theory one step further by allocating to itself a share of the Intelsat revenues produced in part by ground tracking and control facilities located in other states and foreign countries on the notion that these facilities are "invisibly connected" to the California earth station through the satellites. If permitted to stand, California's "invisible connection" theory would nullify the limitations upon state taxing power inherent in the Due Process Clause.

B. The Decision Below Works An Unconstitutional Burden on Interstate and Foreign Commerce

The special formula upheld by the court below likewise runs afoul of the Commerce Clause. As this Court reaffirmed only last Term in *Armco Inc.* v. *Hardesty*, ____ U.S. ____, 104 S.Ct. 2620, 2624 (1984), "A tax that unfairly apportions income from other States is a form of discrimination against interstate commerce." *See also Container Corp.*, *supra* at 2943.

The unfair apportionment that we have demonstrated in detail as violative of the Due Process Clause is not the only basis upon which the special formula is defective under the Commerce Clause. In *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 279 (1977), the Court articulated four tests that must be met for a tax to be valid under the Commerce Clause. The tax must be "applied to an activity with a substantial nexus with the taxing State," must be "fairly apportioned," must "not discriminate against interstate commerce" and must be "fairly related to the services provided by the State."

California's special formula fails the *Complete Auto Transit* test. There is no substantial nexus between California and Intelsat's leasing of its satellites. For the reasons we have already identified in discussing the Due Process Clause, the tax is not fairly apportioned and it is discriminatory against

interstate commerce. As the Court elaborated (with respect to the fourth prong of the *Complete Auto Transit* test) in *Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609, 626-629 (1981):

> Correspondingly, when the measure of a tax bears no relationship to the taxpayer's presence or activities in a State, a court may properly conclude under the fourth prong of the *Complete Auto Transit* test that the State is imposing an undue burden on interstate commerce.

The standard three-factor formula meets the fourth prong of the *Complete Auto Transit* test because the numerators of the three factors are limited to payroll, property and sales in California. The standard formula therefore "relates the tax liability to the value of [taxpayer's] activities within the State." (*Commonwealth Edison Co., supra*, at 629.) The special formula fails the test because the measure of the tax is based in large part on activities (the ownership of satellites and the receipt of space segment and Intelsat revenues) which are not activities within California.

This Court has recognized that "the simple but controlling question [in testing the validity of a state tax under the Commerce Clause] is whether the state has given anything for which it can ask return". *Wisconsin* v. *J.C. Penney Co.*, 311 U.S. 435, 444-445 (1940). The statutory formula, which takes California property, payroll and sales into account, appropriately reflects Comsat's fair share of supporting the State's provision of "police and fire protection, the benefit of a trained work force, and 'the advantages of a civilized society' " (*Commonwealth Edison Co., supra*, at 627). On the other hand, the satellites which permanently orbit the earth in no sense depend upon police and fire protection or any other services provided by California. Inclusion of the satellite property and revenues from both Comsat's and Intelsat's satellite operations in the California numerators would force Comsat to shoulder much more than its "fair share" of supporting California's provision of services. Operation of the satellites is not "presence or

activities" in California to which its tax burden may properly be related. California's special formula which assumes otherwise violates the Commerce Clause.

C. The Decision Below Denies Comsat Equal Protection of the Laws

The decision below also denies Comsat the equal protection of the laws guaranteed by the Fourteenth Amendment. It is settled that a valid distinction in a state tax law "must be reasonable, not arbitrary, and must rest upon some ground of difference having a fair and substantial relation to the legislation." *F.S. Royster Guano Co.* v. *Virginia*, 253 U.S. 412, 415 (1920). Although the Court will not tolerate classifications that are "palpably arbitrary," a state tax classification will be sustained if it is rationally related to a legitimate state purpose. *See Allied Stores of Ohio* v. *Bowers*, 358 U.S. 522, 527 (1959); *Western & Southern Life Ins. Co.* v. *State Board of Equalization*, 451 U.S. 648 (1981).

Here, the unequal classification is not legislative but administrative. Nevertheless, the consequences of the inequality are just as manifest and unjustifiable. California has singled out a non-resident corporation, Comsat, for a special *ad hoc* apportionment formula that it has applied to no other taxpayer. The court below has concluded that orbiting satellites are "used" in California even though they were not launched in California, are permanently located outside California, and never even pass over California. California Franchise Tax Board Regulation 25136 provides that all other tangible personal property permanently located outside California is not considered "used" in California and revenue from it is not to be attributed there. Since the object of apportionment is to determine the income derived within California, there is no rational basis or legitimate state purpose for making a distinction based upon the type of property outside California which generates the income.

The Board's failure to apply its rationale to comparable telecommunications companies is at odds with the values inherent in the Equal Protection Clause. The administrative singling out of Comsat for attribution of out-of-state property and sales to California is even more insulated from the political process than the discriminatory legislative classifications that the Court has struck down. *Cf. Minneapolis Star & Tribune Co.* v. *Minnesota Comm'r of Revenue*, ____ U.S. ____, 103 S.Ct. 1365, 1372 (1983). Equality of treatment is so dominant in our understanding of justice that administrative discretion, where it is allowed a role at all, must pay the strictest heed. This Court should apply that principle by reviewing, and reversing, the judgment below.

CONCLUSION

For the reasons stated, probable jurisdiction should be noted.

Respectfully submitted,

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DATED: December 26, 1984.

APPENDIX

Appendix A

Court of Appeal of the State of California

Civ. No. A016317, First Appellate District, Division Four, entered May 31, 1984, as modified June 29, 1984

Communications Satellite Corporation, Plaintiff and Respondent, v. Franchise Tax Board, Defendant and Appellant.
156 Cal.App.3d 716; 203 Cal.Rptr. 779

OPINION

RATTIGAN, J.*—Plaintiff and respondent Communications Satellite Corporation (hereinafter Comsat) is a District of Columbia corporation doing business in California. It is also a member of an international consortium which owns and operates commercial satellites orbiting in outer space. As a member of the consortium, Comsat owns an interest in the satellites and receives income from their use. It also derives income from transmitting telecommunications signals to the satellites, and receiving signals from them, at an "earth station" located in California and similar facilities elsewhere.

Defendant and appellant Franchise Tax Board (the Board) assessed certain corporate income taxes against Comsat pursuant to a special formula which resulted in an apportionment of its total income, to California, on the bases of factors which included the value of the satellites and income received by Comsat from their use. Comsat paid the taxes and commenced this action against the Board to recover them, challenging the validity of the special formula. After a nonjury trial on stipulated facts and other

*Retired Associate Justice of the Court of Appeal sitting under assignment by the Chairperson of the Judicial Council.

evidence, the court found in favor of Comsat and entered a judgment ordering refund of the disputed taxes plus interest. The Board appeals from the judgment.

The Pleadings

Comsat commenced the action by filing a "Complaint For Refund Of Income Taxes" in which it alleged as follows:

Comsat is a corporation "duly organized and existing" pursuant to the Communications Satellite Act of 1962 (47 U.S.C. § 701, et seq.) and the District of Columbia Business Corporation Act. Its principal place of business is located in Washington, D.C. Comsat returned and paid California income taxes to the Board for the calendar years 1970, 1971, and 1972. In May of 1975, the Board notified Comsat that it "proposed to reassess additional income taxes" for these years. Comsat "protested" the proposed reassessments," but the Board "affirmed the proposed assessments in full and denied . . . [Comsat's] protest." Comsat paid "the additional amounts" and "additional interest," and filed timely claims for refunds. The claims were "disallowed" by the Board.

Comsat further alleged: "The income taxes assessed . . . and the interest paid thereon, were illegally, erroneously and arbitrarily determined, assessed and collected . . . , without factual basis for such determination, assessment and collection," and that they were "void" on specified grounds.

In the prayer of the complaint, Comsat requested "refund" of the additional income taxes paid for the years 1970, 1971, and 1972, "plus all interest paid thereon . . .": interest "on the said amounts of tax and interest paid . . .

from the date of said payments[] to the date of refund"; and general relief.

The Board filed an answer in which it generally denied the allegations made in the complaint.

The Stipulated Facts

After the issues had been joined on the pleadings, the parties filed a written "Stipulation of Facts" executed by their respective attorneys. This document, and the facts stipulated in it, may be summarized and quoted as follows (paragraphing ours):

"Comsat is the United States participant in the International Telecommunications Satellite Consortium ('Intelsat'), an international joint venture which operates the [*sic*] global commercial communications satellite system. The joint venture consisted of 83 member countries as of December 31, 1972. Intelsat was establishd in 1964 by an intergovernmental agreement known as the Agreement . . . for a Global Communications Satellite System, which was signed by the United States Government and other governments. Comsat was designated by the President of the United States as the United States signatory to a companion agreement known as the Special Agreement, which governed the operation of Intelsat."

"The function of the Intelsat system is to relay telecommunications between countries throughout the world. Telecommunications relayed through the . . . system include 'voice' (telephone) traffic, 'record' traffic of various types (telegraph, telex, facsimile, photogram and data)[,] and television."

The Intelsat system consists of a "space segment" and a "ground segment." The assets in the space segment "are owned in undivided shares by members of Intelsat, including Comsat, in varying percentages." In 1970, 1971, and 1972, Comsat's "percentage ownership interest" in these assets was "approximately 52.5 percent." Comsat "serves as manager" of "all facilities" in the space segment.

The assets in the space segment consist of (1) "communications satellites" orbiting in outer space and (2) four "tracking, telemetry[,] and command stations" from which the satellites are "monitored and controlled." The four tracking stations are located in Maine, Italy, Australia, and Hawaii. The satellites are launched into space from Cape Canaveral, Florida. Each satellite is "located in outer space in a 'synchronous' orbit 22,300 miles over a fixed point on the Equator. A 'synchronous' orbit is one in which the orbital speed of the satellite is synchronized with the speed of the earth's rotation so that the satellite appears to remain stationary over a fixed point on earth. Intelsat satellites are positioned over the Atlantic, Pacific, and Indian Oceans. They never pass over California, even during launch."

"A communications satellite performs a function similar to an ordinary microwave tower; it receives and transmits signals carrying telecommunications. The principal difference is that microwave towers must be spaced within a few miles of each other because of the curvature of the earth and because the signals travel in a straight line, while a satellite, being 22,300 miles in space, can receive and transmit signals across thousands of miles of the earth's surface."

The "ground segment" of the Intelsat system consists of "earth stations in various countries owned by entities in the respective countries. Each stations have large antennas with supporting electronic equipment. They transmit signals to, and receive signals from, the satellites. . . . Comsat has a 50 percent ownership interest in seven United States earth stations in the Intelsat system." One of these seven stations (the California earth station) is at Jamesburg, in Monterey County, California, where it was located because of favorable atmospheric and related conditions. The other six earth stations are at Brewster, Washington, and in Maine, West Virginia, Puerto Rico, Hawaii, and Guam. Comsat also owns "a 100 percent interest" in an eighth earth station located at Talkeenta, Alaska. "All of these earth stations became operational before 1970 (with the exception of the Talkeenta station, which did not become operational until July 1970) and remained in operation throughout 1970, 1971[,] and 1972." Comsat "serves as manager" of all of these earth stations except for the one in Guam.

"In addition to the California earth station, Comsat maintains a small engineering office" in Los Angeles County. Intelsat has no property or employees in California.

"Comsat's revenues are generated primarily from the leasing of 'half circuits' . . . to United States international communications common carriers . . . . A 'half circuit' is a two-way communications channel between an Intelsat satellite and an earth station. This channel, when combined with a similar channel (another half circuit) between the satellite and another earth station, permits the establishment of a whole satellite circuit capable of carrying telecommunications between the two earth stations. In order to be able

to lease half circuits to the carriers, Comsat leases from Intelsat capacity in the Intelsat satellites and pays 'use charges' to Intelsat for such capacity." All of Intelsat's revenues are generated by "use charges."

"Comsat is not involved in transmitting telecommunications between the California earth station [at Jamesburg] and other points in California and does not receive any income from such transmission. Comsat's activities at the California earth station are concerned only with the leasing of half circuits between the California earth station and Intelsat satellites. The California earth station communicates with Intelsat satellites operating in the Pacific Ocean region."

"The California earth station operates as follows: (1) A communications signal destined for a foreign country or an offshore United States point is received at the California earth station from its place of origin in the United States through terrestrial facilities (telephone lines, microwave relay systems, etc.) owned and operated by communications carriers other than Comsat. (2) The earth station transmits the signal to an Intelsat satellite in orbit, which in turn transmits it to an earth station in a foreign country or an offshore United States point. (3) Likewise, communications from foreign countries and offshore United States points are received via satellite by the California earth station and are then transmitted to their point of destination in the United States through terrestrial facilities owned and operated by communications common carriers other than Comsat. The telecommunications transmitted by the California earth station originate at, and the telecommunications received by the California earth station terminate at, locations all over the United States."

The rates charged by Comsat for half circuits are regulated by the Federal Communications Commission "according to the traditional 'rate base' method of regulation. Under this method, Comsat is permitted to make charges designed, but not guaranteed, to generate revenues sufficient to cover its operating expenses (including taxes and depreciation) and provide a fair return on its rate base. The 'rate base' consists chiefly of the investment in property devoted to the regulated business."

In addition to the revenues it derives from leasing half circuits, Comsat receives 52.5 percent of Intelsat's gross revenues by reason of its (Comsat's) 52.5 percent ownership interest in the assets in Intelsat's space segment.

As of December 31, 1970, Comsat had leased to its customers 2,139 half circuits, of which 405 were between the California earth station and Intelsat satellites (California half circuits). The "original cost" of Comsat's interest in the eight U.S. earth stations during 1970 was $43,492,000, of which $3,835,846 (8.8197 percent) was attributable to the Jamesburg station. The "original cost" of Comsat's interest in the Intelsat satellites in orbit as of December 31, 1970, was $65,893,307.

As of December 31, 1971, Comsat had leased to its customers 2,537 half circuits, of which 468 were California half circuits. The "original cost" of Comsat's interest in the earth stations during 1971 was $43,810,000, of which $3,933,460 (8.9785 percent) was attributable to the Jamesburg station. The "original cost" of Comsat's interest in the Interest satellites in orbit as of December 31, 1971, was $88,355,540.

As of December 31, 1972, Comsat had leased to its customers 2,971 half circuits, of which 490 were California

half circuits. The "original cost" of Comsat's interest in the eight earth stations during 1972 was $47,477,000, of which $4,114,449 (8.6662 percent) was attributable to the Jamesburg station. The "original cost" of Comsat's interest in the Intelsat satellites in orbit as of December 31, 1972, was $132,006,758.

"In 1970, 1971[,] and 1972, Comsat derived its income from sources both within and without California, and therefore was subject to the apportionment provisions of section 25101 et seq. of the Revenue and Taxation Code . . . ."

The Law Involved

As will appear, the issue on this appeal requires identification of the apportionment formula which should be used to determine the corporate income tax owed and payable by Comsat for each of the years in dispute. In the passage last quoted from the stipulation of facts, the parties agreed that the propriety of the formula is controlled by the Uniform Division of Income for Taxation Purposes Act (hereinafter the Uniform Act), which appears in the Revenue and Taxation Code.[1] A discussion of the Uniform Act will be interpolated at this point.

The Uniform Act was proposed in 1957 by the National Conference of Commissioners on Uniform State Laws.

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[1]Statutory references are to the Revenue and Taxation Code unless otherwise indicated. The Uniform Act appears as article 2 (commencing with § 25120) of chapter 17 (Allocation of Income, commencing with § 25101) of part 11 (Bank and Corporation Tax Law, commencing with § 23001) of division 2 (Other Taxes, commencing with § 6001).

It was intended to promote uniformity in allocation practices among the states which impose taxes on, or measured by, the incomes of corporations. (See Keesling & Warren, *California's Uniform Division of Income for Tax Purposes Act* (1967) 15 U.C.L.A. L.Rev. 156.) The Uniform Act was enacted into California law in 1966. (Stats. 1966, ch. 2, § 7, p. 177.) It has also been adopted by at least 23 other states. (See Table, 62 West's Ann. Rev. & Tax Code (1984 pocket supp.) p. 140.)

The pertinent provisions of the Uniform Act may be summarized as follows: Any taxpayer who receives income from business activity inside *and* outside the state must "apportion" its net business income to the state. (§ 25121.) The taxpayer's total net business income is apportioned to California by multiplying the total by a fraction, of which (1) the numerator is the sum of the "property factor," the "payroll factor," and the "sales factor," and (2) the denominator is "three." (§ 25128.)[2]

Each of the three "factors" mentioned is itself a fraction which is defined by a provision in the Uniform Act. The numerator of the property factor fraction is the "average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the income year." The denominator is the "average value of [all] the taxpayer's real and tangible personal property owned

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[2]Section 25128 reads as follows: "All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three."

or rented and used . . . during the income year." (§ 25129; see also §§ 25130, 25131.)[3]

The numerator of the payroll factor fraction is the "total" compensation paid by the taxpayer in this state during the income year. The denominator is the "total compensation paid everywhere during the income year." (§ 25132.)[4]

The numerator of the sales factor fraction is the sum of "the total sales of the taxpayer" in this state during the income year. The denominator is the sum of the taxpayer's total sales "everywhere" during the income year. (§ 25134.)[5]

The Uniform Act also provides that the taxpayer may request, or the Board may require, variation from the stan-

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[3]These sections respectively provide (in full or in pertinent part, as shown):

"25129. The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the income year and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the income year.

"25130. Property owned by the taxpayer is valued at its original cost. . . .

"25131. The average value of property shall be determined by averaging the values at the beginning and ending of the income year. . . ."

[4]Section 25132 reads: "The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the income year by the taxpayer for compensation and the denominator of which is the total compensation paid everywhere during the income year."

[5]Section 25134 provides: "The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the income year, and the denominator of which is the total sales of the taxpayer everywhere during the income year."

dard formula if it does "not fairly represent the extent of the taxpayer's business activity" in California; and that the variation may, "if reasonable," consist of the "exclusion of any one or more" of the three factors described above, or the "inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state," or the "employment of any other method which will effectuate an equitable allocation and apportionment of the taxpayer's income" to California.[6]

Comsat's Apportionment Formula

We return to the stipulation of facts. In 1970, 1971, and 1972, pursuant to the provisions of the Uniform Act described above, Comsat "apportioned its net income to California by use of a three-factor formula based on property, payroll, and sales." We now find it necessary to describe Comsat's calculations (and later the Board's) with the complicated details shown in the stipulation. We depart from the parties' exact language on occasion, but not from the essential facts to which they stipulated.

Comsat's Calculation of Its Property Factors

In pertinent part, the stipulation continues as follows: "In each of the income years in question, Comsat computed

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[6]Section 25137 provides: "If the allocation and apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the Franchise Tax Board may require, in respect to all or any part of the taxpayer's business activity, if reasonable: [¶] (a) Separate accounting; [¶] (b) The exclusion of any one or more of the factors; [¶] (c) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or [¶] (d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income."

the property factor according to the fraction prescribed by section 25129 . . . ." (See fn. 3, *ante.*) The numerator of Comsat's fraction for each year was the value, in the particular year, of Comsat's interest in real and tangible personal property in California (i.e., the California earth station at Jamesburg and the office in Los Angeles County). Comsat thus excluded from its numerator (i.e., from the value of its California property) any value representing its interest in the Intelsat satellites. Its denominator was the value, in the particular year, of its interest in all real and tangible personal property everywhere, "including its undivided [52.5%] interest in the Intelsat satellites. . . ."[7]

The property factor Comsat calculated from this fraction for 1970, expressed as a percentage, was 2.8296 percent. In fraction format, with translations to the real dollar figures Comsat used for 1970, its calculation of the property factor may be shown as follows:

$$\frac{\text{Value of Comsat's interest in California property in 1970}}{\text{Value of Comsat's interest in property everywhere in 1970, "including its undivided 52.5% interest" in the satellites}} = \frac{\$\ 3{,}761{,}556}{\$132{,}933{,}655} = 2.8296\%$$

Comsat made similar calculations for each of the other years in question. The property factors it produced were 2.5464 percent for 1971 and 2.2114 percent for 1972.

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[7]The stipulation of facts shows that the value Comsat assigned to each item in the fraction was the "original cost" of the respective item. The value Comsat actually used for each item was its "original cost" averaged for the year pursuant to sections 25130 and 25131. (See fn. 3, *ante.*) This is demonstrated in documentary evidence received at the trial pursuant to a provision in the stipulation.

Comsat's Calculation of Its Payroll Factors

We here quote the stipulation of facts as follows: "In each of the years in question, Comsat computed the payroll factor according to the fraction prescribed by section 25132 . . . . [See fn. 4, *ante.*] The numerator consisted of Comsat's payroll in California and the denominator consisted of its payroll everywhere. . . . The payroll factors thus computed by Comsat, expressed as percentages, were as follows:

"Income Year	California Payroll	Total Payroll	Payroll Factor (%)
1970	$1,027,479	$18,684,397	5.4991
1971	1,052,343	18,611,076	5.6544
1972	1,014,981	19,404,994	5.2305"

Comsat's Calculation of Its Sales Factors

Comsat calculated its sales factor for each of the years in question by using a fraction in the format prescribed by section 25134. (See fn. 5, *ante.*) The numerator of the fraction used in each year was a figure which Comsat called "California earth station revenue" and which excluded any part of the revenue Comsat had received from Intelsat, in that year, by reason of its (Comsat's) interest in the satellites. Comsat limited its "California earth station revenue" (i.e., its numerator) to a so-called "ground percentage" of the revenue it had received from leasing half circuits at its California earth station in the particular year. It calculated the "ground percentage" by dividing (1) the "net book value" of the real and tangible personal property at the eight earth stations in the year by (2) the "net book value" of all its real and tangible personal property everywhere in the year,

including its interest in the satellites. Its calculation of the "ground percentage" in each year may be shown in fraction format as follows (we here quote the stipulation of facts in pertinent part):

$$\left[\frac{\text{"net book value of all Comsat earth stations' real and tangible personal property in service}}{\text{"Net book value of all Comsat real and tangible personal property in service"}}\right] = \text{ground percentage}$$

Comsat next applied the "ground percentage" to the dollar amount of revenue it had received from leasing half circuits at the California earth station in the particular year. It had separately compiled this dollar amount for 1972, but not for 1970 and 1971. It accordingly calculated the amount for 1970 and 1971, and the numerator (California earth station revenue) for each year, by using this two-step formula:

(1)

$$\left[\begin{array}{l}\text{Ground percentage for the year}\end{array}\right] \times \left[\begin{array}{l}\text{Total revenue received from leasing of half circuits at all earth stations during the year}\end{array}\right] = \begin{array}{l}\text{Revenue attributed to all earth stations for the year}\end{array}$$

(2)

$$\left[\begin{array}{l}\text{Revenue attributed to all earth stations for the year per step No. 1}\end{array}\right] \times \left[\frac{\text{Number of half circuits leased through California earth station in the year}}{\text{Number of half circuits leased through all earth stations in the year}}\right] = \begin{array}{l}\text{California earth stations revenue (Comsat's numerator) for 1970 and 1971}\end{array}$$

As previously stated, Comsat had compiled a figure representing the revenue attributable to its leasing of half circuits at the California earth station in 1972. It accordingly calculated its "California earth station revenue" for that year (i.e., the numerator of its sales factor fraction for 1972) by applying its 1972 "ground percentage" to the figure, as follows:

1972 ground percentage	×	Revenue attributed to Comsat's leasing of half circuit at its California earth station in 1972	=	California earth station revenue (Comsat's numerator) for 1972

According to the stipulation of facts as pertinent here, the denominator of Comsat's sales factor fraction for each of the three years was its total revenue: i.e., the sum of the revenue it had received "from leasing half circuits" at all the earth stations and its "share of Intelsat revenue" in the particular year. Applying the fraction for each year, Comsat calculated its sales factors as 4.4214 percent for 1970, 3.0098 percent for 1971, and 3.0039 percent for 1972.[8]

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[8]The step-by-step calculations which produced Comsat's numerator and denominator for each year, in dollars, do not appear in the stipulation of facts or in the documentary evidence. The numerators and denominators themselves, and the sales factors computed from them by Comsat, are shown in the documentary evidence as follows:

	Numerator (California earth station revenue)	Denominator (Total revenue)	Percentage Sales Factor (no. 1 divided by No. 2)
1970	$4,442,362	$104,737,032	4.2414%
1971	$3,707,712	$123,186,481	3.0098%
1972	$4,267,174	$142,053,550	3.0039%

Comsat's Apportionment Factor and Further Administrative Proceedings

Having calculated its property, payroll, and sales factors for each of the three years as described, Comsat added the three percentage figures for each year, and divided their sum by three, as prescribed by section 25128. (See fn. 2, *ante*.) It thereby produced averaged percentages of its "business income . . . apportioned to this state" (see *ibid.*) which it showed on its corporate income tax returns as 4.1900 percent for 1970, 3.7369 percent for 1971, and 3.4819 percent for 1972. Its California income tax for each year was computed and paid accordingly.

In 1974 and 1975, the Board notified Comsat that it (the Board) "proposed adjustments" for 1970, 1971, and 1972 on the basis that it had "revised" some of the factors Comsat had calculated. The Board's "revised" factors are described next.

The Board's Property Factors

In calculating Comsat's property factor for each of the three years, the Board also used a fraction in the format prescribed by section 25129 (see fn. 3, *ante*) but with a numerator greater than Comsat's. The Board enhanced Comsat's numerator by adding to it (i.e., adding to the value of its California property) a fraction of the value of Comsat's interest in the satellites in the particular year. The fraction used by the Board for this purpose was calculated as (1) the value (original cost averaged for the year pursuant to sections 25130 and 25131) of Comsat's interest in real and tangible personal property on the ground in California (i.e., of its interest in the earth station at Jamesburg and the office in Los Angeles

County) divided by (2) the value (similarly averaged) of its interest in real and tangible personal property on the ground everywhere (i.e., excluding the value of Comsat's interest in the satellites).

Application of this fraction to the value of Comsat's interest in the satellites during the particular year (again, their original cost averaged for the year pursuant to sections 25130 and 25131) produced a result which the Board called "Value of satellites to be apportioned to California." The numerator of the Board's property factor fraction was the sum of this value and the value of Comsat's interest in property on the ground in California (No. 1 above). The Board used the same denominator Comsat had use: i.e., the value, similarly averaged for the year, of Comsat's interest in all real and tangible personal property everywhere during the year, including the satellites.

Working out this fraction for 1970, the Board calculated a property factor of 4.9187 percent. The calculation may be shown in fraction format, with its elements designated for reference, as follows:

$$\frac{\left[\dfrac{\text{(a) Value of Comsat's interest in property in California}}{\text{(b) Value of Comsat's interest in property everywhere } \textit{except for} \text{ the satellites}} \times \text{(c) Value of the satellites}\right] = \text{(d) "Value of satellites apportioned to California}}{\text{(e) Value of Comsat's interest in property everywhere, including the satellites}} + \text{(a)}$$

$$= 4.9187\%$$

With the real dollar figures used by the Board for 1970, its property factor fraction for that year may be shown as follows:

$$\left[\frac{\text{(a) \$ 3,761,556}}{\text{(b) \$76,475,116}} \times \text{(c) \$56,458,539}\right] =$$

$$\frac{\text{(d) \$2,777,026} + \text{(a) \$3,761,556} = \text{\$6,538,582}}{\text{(e) \$132,933,655}} = 4.9187\%$$

Similar calculations by the Board produced property factors of 4.8429 percent for 1971 and 4.8280 percent for 1972.

The Board's Payroll Factors

The payroll factors Comsat had calculated for 1970, 1971, and 1972 were accepted by the Board without dispute.

The Board's Sales Factors

In calculating Comsat's sales factors for 1970, 1971, and 1972, the Board also used a fraction in the format prescribed by section 25134. (See fn. 5; *ante.*) With some editorial interpolations by this court, the Board's fraction is partly described in the stipulation of facts as follows:

"For each of the years in question, the Board determined that . . . [Comsat's] . . . sales attributable to California (the numerator of the fraction used [by the Board] for the sales factor) consisted of a portion of Comsat's revenue from Intelsat and a portion of its revenue from . . . [the leasing of half circuits everywhere] . . . . The denominator consisted of [Comsat's] total revenue" from the two sources described.

"The formula used by the Board in determining the portion of Comsat's revenue from Intelsat and the portion of its revenue from . . . [the leasing of half circuits everywhere] . . . to be included in the numerator of the sales factor was as follows:

$$\frac{\text{"California half circuits leased by Comsat}}{\text{Half circuits leased by Comsat everywhere}} \times \text{Revenue from Intelsat} + \text{Revenue from rental of all half circuits} = \text{Portion of revenue from Intelsat and portion of half circuit revenue to be apportioned to California"}$$

"Basing said computation on information then available to it, the Board determined that the sales factor for each of the years in question, expressed as a percentage, was 16.4154 [%]."[9]

The stipulation thus describes the Board's sales factor fraction and the result it yielded, but without illustration. Translating some of the stipulation's nomenclature for clarity, and designating the elements of the fraction the

[9]The Board calculated an identical sales factor of 16.4154 percent "for each of the years in question" because the "information then available to it" required it to make a one-time calculation with 1972 figures only. The requirement and the result (and errors in the calculation) are described later in this opinion.

Board used for the year 1972 only (see fn. 9, *ante*), we reconstruct the full fraction as follows:

$$\frac{\left[\begin{array}{l}\text{(a) Number of half circuits leased by Comsats at the California earth station in 1972}\\ \hline \text{(b) Number of half circuits leased by Comsat at all earth stations in 1972}\end{array}\right] \times \left[\begin{array}{l}\text{(c) Comsat's total 1972 revenue (its share of Intelsat's satellite revenue in 1972 } \textit{plus} \text{ the revenue it received from leasing half circuits at all earth stations in 1972}\end{array}\right] = \text{(d) Comsat's 1972 revenue "apportioned to California"}}{\text{(c) Comsat's total 1972 revenue (the same as shown in (c) above)}} = 16.4154\%$$

The Board's Apportionment Factor and Further Administrative Proceedings

Adding its property and sales factors to Comsat's undisputed payroll factor for each year and dividing the sum by three, pursuant to section 25128 (see fn. 2, *ante*), the Board calculated percentage figures apportioning Comsat's income to California at 8.9444 percent for 1970, 8.9709 percent for 1971, and 8.8246 percent for 1972.[10]

[10]The parties' disparate calculations of the various factors, and their respective results, are tabulated here as follows:

	1. Property Factor	2. Payroll Factor (Undisputed)	3. Sales Factor	Percentage of Income Apportioned to California (1+2+3 Divided by 3)
1970				
Comsat	2.8296%	5.4991%	4.2414%	4.1900%
Board	4.9187%	5.4991%	16.4154%	8.9444%
1971				
Comsat	2.5464%	5.6544%	3.0098%	3.7369%
Board	4.8429%	5.6544%	16.4154%	8.9709%
1972				
Comsat	2.2114%	5.2305%	3.0039%	3.4819%
Board	4.8280%	5.2305%	16.4154%	8.8246%

The Board thereupon notified Comsat that it "proposed to assess additional income taxes" for those years in specified amounts based on the Board's revised apportionment formula. Comsat "protested the proposed assessments." The Board denied the protest and gave formal notice of its assessment of the additional income taxes. Comsat paid them and filed claims for refunds, which were also denied. Comsat thereupon commenced this action. The stipulation of facts includes the following language: "Comsat has exhausted its administrative remedies with respect to said refund claims and has timely commenced this action for refund."

"The Board's assessment of additional taxes for each of the income years in question was based on its employment of property and sales factors differing from those prescribed [sic] in sections 25129 and 25134, respectively . . . . In so adjusting the formula used to apportion Comsat's net income for 1970, 1971 and 1972, the Board relies on the authority granted to it by section 25137 . . . ." (See fn. 6, *ante*.)

The Trial

Comsat called three witnesses at the nonjury trial. Martin Levine its "Director of Taxes," testified that Comsat pays "property taxes in California on its Jamesburg earth station."

John F. Utley testified as follows: He is associated with an accounting firm which acts as Comsat's "auditors." He had been "retained as an expert in this case." At Comsat's request, he had prepared a report as to "whether the three factor apportionment formula used by Comsat fairly represented the extent of Comsat's business activi-

ties in California" in the years 1970, 1971 and 1972, and "whether the alternative formula proposed by the Board produced a result which was consistent with Comsat's business activity in California during the same years."

Utley further testified that the "calculations" made by Comsat in computing the payroll factor, pursuant to section 25132, were "clearly in accordance with the statute's requirements. . . ."[11] In the numerator of the property factor fraction for each of the years in question, Comsat "included all its interest in the Jamesburg earth station and the . . . Los Angeles engineering office, but did not include any of the cost of its interest in the Intelsat satellites, which clearly are not property used in any stretch of the imagination in California." The "property factor as derived by Comsat fairly represents the extent of Comsat's business activity related to property in California during the years in question." As to the sales factor, Utley testified that Comsat's figures "fairly represent the extent of Comsat's business activity related to sales in California during the years in question," and that the figures "may be slightly overstated" because "there is no market of Comsat [*sic*] in California."

Utley also testified to his opinions that the Board's calculation of the property factors was "unreasonable"; that it did not "represent the extent of Comsat's business activity in California"; and that it did not "result in an equitable allocation of income related to property." He

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[11]This testimony by Utley was received over an objection, by counsel for the Board, that "interpretation" of the statute was properly a function of the court alone. He testified in like manner over a "continuing objection" to the same effect.

expressed essentially the same opinion as to the sales factors computed by the Board.

A. J. Stotler, the manager of the earth station at Jamesburg, testified that there is "no reason" why Comsat has to have an earth station in California. The signals transmitted and received at the California earth station could be "rerouted" through the earth station at Brewster, Washington.

Subsequent Proceedings

At the conclusion of posttrial arguments by counsel, the trial court stated from the bench that "there will be a finding in favor of . . . Plaintiff [Comsat] on the complaint . . ." The Board requested written findings of fact and conclusions of law. The trial court eventually signed and filed findings and conclusions which we quote in pertinent part as follows:

"The Court finds the following facts to be true . . . .

"1. The facts as stated in the Stipulation of Facts filed herein are established as true. The Court hereby incorporates the Stipulation of Facts into these Findings of Fact by reference as though fully set forth and finds each fact stipulated to be true.

"..... .....

"5. The property factors computed by Comsat are accurate. It is not true that the standard statutory property factor set forth in § 25129 . . . as computed by Comsat does not fairly represent the extent of Comsat's activity related to property in California, for each of the years in question.

"..... .....

"11. The sales factors computed by Comsat are accurate. It is not true that the standard statutory sales factor set forth in § 25134 . . . as computed by Comsat does not fairly represent the extent of Comsat's activity related to sales in California, for each of the years in question.

"12. The apportionment factors computed by Comsat are accurate. It is not true that the apportionment factors as computed by Comsat do not fairly represent the extent of Comsat's business activity in California, in each of the years in question.

"13. The property factor employed by [the] . . . Board . . . to apportion Comsat's income differs from the property factor described in § 25129 . . . in that it includes property not located within the state, namely, a portion of the taxpayer's interest in communications satellites located in outer space.

"14. The sales factor employed by the Board to apportion Comsat's income differs from the sales factor described in section 25134 . . . in that it includes receipts from the rental or other use of tangible personal property located outside this state, namely, a portion of the receipts from the leasing of Intelsat circuits, and a portion of half circuit rentals attributable to the use of satellites located in outer space.

"..... .....

"CONCLUSIONS OF LAW

"The Court makes the following Conclusions of Law:

"..... .....

"8. The . . . Board bears the burden of proving that the standard statutory provisions do not fairly represent the extent of the taxpayer's activity in California before it may employ a special allocation and apportionment method. The . . . Board has not carried its burden of proof.

"

"11. The income taxes determined and assessed to Comsat and collected by the Board in the amounts of $28,307.65 for the year 1970; $136,460.49, for the year 1971; and $151,576.76 for the year 1972; and the interest paid thereon, were illegally, erroneously and arbitrarily determined, assessed and collected by the Board, without factual basis for such determination, assessment and collection, and are void . . . ."

A judgment for the specified amounts was accordingly entered in favor of Comsat. This appeal followed.

Review

I

The Board contends that this court is not bound by the findings of fact made by the trial court because "this case involves the application of a statute to uncontradicted facts." This argument must be sustained. The application of a taxing statute to uncontradicted facts is a question of law, and this court is accordingly not bound to accept the trial court's findings of fact made from the uncontradicted facts shown in the parties' stipulation and the documentary evidence. (See *Southern California Edison Co. v. State Board of Equalization* (1972) 7 Cal.3d 652, 659, fn. 8 [102 Cal.Rptr. 766, 498 P.2d 1014]; *Anaconda*

Co. v. Franchise Tax Board (1982) 130 Cal.App.3d 15, 23 [181 Cal.Rptr. 640]; *Peninsula Covenant Church v. County of San Mateo* (1979) 94 Cal.App.3d 382, 391 [156 Cal.Rptr. 431]; *Chase Brass & Copper Co. v. Franchise Tax Bd.* (1970) 10 Cal.App.3d 496, 502 [95 Cal.Rptr. 805]; *Standard Register Co. v. Franchise Tax Board* (1968) 259 Cal.App.2d 125, 129-130 [66 Cal.Rptr. 803].)

Comsat argues that Utley's testimony supports the trial court's findings that the results of Comsat's calculations fairly represented its business activity in California, and that the findings must therefore be sustained on appeal pursuant to the substantial evidence rule. We reject this argument for two reasons.

In the first place, the validity of Comsat's calculations depends on resolution of the legal question whether the income it received from the use of the satellites was subject to taxation by the State of California. The trial court's determination of this question is a conclusion of law, not a finding of fact, and it is not binding on this court. (*McNeil v. Board of Retirement* (1958) 51 Cal.2d 278, 284-285 [332 P.2d 281]; *Pac. Pipeline Const. Co. v. State Board of Equal.* (1958) 49 Cal.2d 729, 736 [321 P.2d 729].)

Moreover, Utley's testimony was essentially to the effects that the results of Comsat's calculations "fairly represent Comsat's business activity in California" and that the Board's results did not. This testimony reflects his views on questions of law based on his interpretation of provisions of the Uniform Act. An expert witness may not properly testify on questions of law or the interpretation of a statute. (See *Elder v. Pacific Tel. & Tel.*

Co. (1977) 66 Cal.App.3d 650, 664 [136 Cal.Rptr. 203]; *People v. Clay* (1964) 227 Cal.App.2d 87, 98 [38 Cal. Rptr. 431, 100 A.L.R.2d 1421].) Utley's testimony in these respects was received over a timely objection made on the appropriate ground. (See fn. 11, *ante.*) The testimony, and the trial court's findings based on it, are therefore not binding on this court. (See *Standard Register Co. v. Franchise Tax Board, supra,* 259 Cal.App.2d 125 at pp. 129-130; 6 Witkin, Cal. Procedure (2d ed. 1971) Appeal, § 256, pp. 4247-4248.) We proceed with an independent review of the uncontradicted evidence shown in the stipulated facts and the documents introduced at the trial. (See *Southern California Edison Co. v. State Board of Equalization, supra,* 7 Cal.3d 652 at p. 659, fn. 8; *Peninsula Covenant Church v. County of San Mateo, supra,* 94 Cal.App.3d 382 at p. 391.)

II

The parties expressly stipulated that when the Board recalculated Comsat's property and sales factors it "relie[d] on the authority granted it by section 25137." That statute provides in effect that the Board may deviate from the "allocation and apportionment provisions" of the Uniform Act if their application produces results which do "not fairly represent the extent of the taxpayer's business activity in this state"; and that the deviation, "if reasonable," may consist of "(d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income" to California. (See § 25137 as quoted in fn. 6, *ante.*) In the first instance, therefore, the Board was warranted in recalculating the property and sales factors if the results of their computa-

tion by Comsat, pursuant to sections 25129 and 25134, did not "fairly represent" Comsat's "business activity in this state."

We have seen that Comsat produced a property factor for each year in the fraction format prescribed by section 25129. The denominator of Comsat's property factor fraction was the total value of its real and tangible personal property everywhere, as section 25129 prescribes. (See fn. 3, *ante*.) In its numerator, however, Comsat did not include any value assigned to the satellites orbiting in outer space. Section 25129 provides in pertinent part that the numerator of the property factor fraction shall include the "value of the taxpayer's real and tangible personal property owned . . . and used in this state during the income year." (See *ibid.*) Comsat's exclusion of a satellite value from its numerator obviously rested on the premise that the satellites are not *located* "in this state."

The pertinent language of section 25129 defining the numerator of the property fraction refers to property "owned" and "used" in this state, not to property "located" here. Moreover, the satellites are not located in California but the Jamesburg earth station is. Because it is, Comsat is conducting "business activity" and generating income in California. There is an invisible, but apparently continuous and very real, connection between the earth station and the satellites. The earth station has a value only because this connection exists, and it is otherwise of no value. Without the connection, the satellites function in outer space to no purpose involving this state. With it, they function in California. The ascription of a "function in California" to the satellites is a recognition of the

realities of telecommunications and space technology, not an indulgence in fiction.

Because Comsat owns an interest in the satellites, and because they function in California at and through the Jamesburg earth station, we conclude that they are "tangible personal property owned . . . and used in this state," by Comsat, within the meaning of section 25129. (See fn. 3, *ante.*) Comsat's exclusion of their value from the numerators of its property factor fractions therefore produced results which, for purposes of the factor, did not "fairly represent the extent of the taxpayer's business activity in this state" within the meaning of section 25137. (See fn. 6, *ante.*) This being so, the statute authorized the Board to recalculate Comsat's property factors by using "any other method" which was "reasonable" and would "effectuate an equitable allocation and apportionment of the taxpayer's income" to California. (See *ibid.*)

The Board's method also involved the use of a fraction format, which was "reasonable" because it was permitted —but not required—by section 25137, subdivision (d). The Board used a numerator which included a value assigned to the satellites. This was done on the theory that the satellites were "tangible personal property owned . . . and used in this state," as we have concluded. For purposes of the numerator, the Board fixed their value as a fraction of their total value based on the ratio between (1) the value of Comsat's real and tangible personal property at the two locations and (2) the total value of its real and tangible personal property everywhere except for the satellites. This step was taken on the theory that the same California-versus-everywhere ratio should be applied in fixing the

value of Comsat's interest in the satellites for purposes of the numerator. The two theories described, and their successive applications in the Board's numerator, were "reasonable." The Board completed its property factor fraction by adding the value of Comsat's other California property to the numerator and using the total value of its property everywhere as the denominator. Each of these steps was "reasonable" because it was consistent with section 25129. (See fn. 3, *ante*.) The overall property factor fraction was "reasonable" as the sum of its parts. The Board's consequent property factor for each year, expressed as a percentage, was accordingly authorized by law and valid in fact.

Comsat also calculated its sales factor for each year in the fraction format prescribed by section 25134 (see fn. 5, *ante*), but it used a numerator which (1) was limited to a so-called "ground percentage" of the revenue Comsat received from leasing half circuits at the California earth station in the year and which (2) excluded any part of the revenue Comsat received from Intelsat in that year by reason it its (Comsat's) interest in the satellites. For purposes of the section 25134 numerator, and as pertinent here, the Uniform Act defines the term "sales" as the taxpayer's "gross receipts" (§ 25120, subd. (e)) and the term "sales of the taxpayer in this state" with reference to the location of the "income-producing activity" in California or its location as between California and "any other state." (§ 25136.)[12]

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[12]As pertinent to the stipulated facts, sections 25120 and 25136 respectively provide:

"25120. As used in Section 25120 to 25139, inclusive, which shall hereafter be referred to as 'this act,' unless the context otherwise

Comsat apparently calculated its "sales" as "sales in this state," only, on the theory that the pertinent "income-producing activity" was conducted at the California earth station only; and applied a "ground percentage" to it to exclude any part of the "sales in this state" which were attributable to the satellites (as distinguished from the earth station itself). The latter step involved a subformula which was not expressly authorized by section 25129. Even if use of the subformula was permissible, it had the effect of omitting from Comsat's "sales in this state" any California half circuit revenue attributable to the use of the satellites. This exclusion, and the parallel omission of any part of the revenue Comsat received from Intelsat by reason of its (Comsat's) interest in the satellites, turned up a numerator which was substantially less than the sum of its actual "sales in this state" for purposes of 25134.

The denominator of Comsat's sales factor fraction comported with section 25134 because it was the total of Comsat's "sales" everywhere i.e., its "gross receipts" from the leasing of half circuits everywhere and its share of satellite revenue received from Intelsat. Because of the diminished numerator, however, the fraction produced a percentage result which, for purposes of the sales factor, did "not fairly represent the extent of the taxpayer's business activity in this state" within the meaning of section

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requires: [¶] (e) 'Sales' means all gross receipts of the taxpayer . . . ."

"25136. Sales . . . are in this state if: [¶] (a) The income-producing activity is performed in this state; or [¶] (b) The income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance."

25137. (See fn. 6, *ante.*) Again, the Board was authorized by section 25137, subdivision (d), to recalculate the sales factors by employing "any other method" which was "reasonable" and would "effectuate an equitable allocation and apportionment" of Comsat's income to California. (See *ibid.*)

The sum, however, was properly the denominator of the sales factor fraction—as both parties used it—because it represented Comsat's "sales" everywhere. As a numerator reducing it to Comsat's "sales in this state" only, the Board used a fraction of the sum based on the ratio between the number of half circuits Comsat leased at the California earth station and the number of half circuits it leased everywhere. Stated another way, the Board's numerator represented a calculation of Comsat's "sales in this state," from its "sales" everywhere, in the same proportion its telecommunications traffic at the California earth station bore to its telecommunications traffic everywhere. The calculation was "reasonable" because it fairly apportioned Comsat's "sales" to California.

The Board's numerator included part of the revenue Comsat had derived from leasing half circuits. That part was properly characterized as Comsat's "sales in this state" because the "income-producing activity" which generated it was the leasing of half circuits at the California earth station: i.e., the activity was "performed in this state" within the meaning of section 25136, subdivision (a). (See fn. 12, *ante.*) The balance of the numerator was part of the satellite revenue Comsat received from Intelsat. The "income-producing activity" which generated that revenue was the operation of the satellites themselves. Because they

actually "function" at the California earth station (as we have seen), their "income-producing activity" is also "performed in this state" within the meaning of section 25136, subdivision (a). For that reason, the part of Comsat's "sales" representing revenue from their use was properly characterized as its "sales in this state" within the same meaning.

The calculation of the Board's numerator was thus "reasonable" because it applied the concept of "sales in this state" which is provided in section 25134 (see fn. 5, *ante*), and because it did this on a reasonable basis of apportionment. The Board's use of Comsat's "sales" everywhere as the denominator was "reasonable" because it was also consistent with section 25134. (See *ibid.*) As we concluded with regard to the Board's property factor, its sales factor fraction was "reasonable" as the sum of its parts. The Board's consequent sales factor, expressed as a percentage, was accordingly authorized by law.

We here reach the fact that the Board calculated the sales factor at 16.4154% for each of the three years in question. (See fn. 9, *ante*.) Comsat complains of this on the appeal, contending in effect that the results are necessarily inaccurate because the figures used in the calculation (Comsat's total revenue, the number of half circuits it leased, and the number of half circuits it leased everywhere) differed from year to year.

The parties stipulated that the Board's calculation of the 16.4154 percent sales factor for each year was "[b]ased on information then available to it. . . ." (See fn. 9 and the accompanying text *ante*.) This passage is not explained in the stipulation, but it fairly appears that the half circuit

numbers "then available" to the Board were for 1972 only; that it computed the 1972 sales factor with those numbers and Comsat's total revenue for 1972 (see fn. 8); that the result was a 1972 sales factor of 16.4154 percent; and that the Board applied the same factor in 1970 and 1971 because it lacked half circuit numbers for those years. It further appears that the Board's half circuit numbers for 1972 were wrong, or that it made an arithmetical error in the calculation.

However, all of the pertinent figures for each year are accurately shown in the stipulation of facts or the documentary evidence received at the trial. They demonstrate that their use in the Board's sales factor fraction would have produced a sales factor of 16.4928 percent for 1972, not 16.4154 percent; and sales factors in excess of 18 percent for each of the other years. Because errors or omissions in the Board's calculations thus favor Comsat, the latter has no cause to complain. We treat the Board's sales factors as valid in fact.

III

The parties exchange opposing contentions as to which of them bears the burden of proof on such issues as the validity of Comsat's calculation of its property and sales factors. The trial court concluded that the burden was on the Board (see its conclusion of law No. 8, quoted *supra*), but we need not decide this question. If the Board has the burden, it has been sustained.

The parties argue many other points in their lengthy briefs. The points include such subjects as the effect of the Board's action in other jurisdictions reached by the

Uniform Act and whether the Board has followed its own administrative precedents in this case. Consideration of all of these points is not essential to our disposition of the controversy before us. With two exceptions, we do not reach them.

The first exception is a contention by Comsat that application of the Board's special apportionment formula denies it (Comsat) due process and equal protection of the laws. This contention was raised in the pleadings, but the trial court did not reach it for obvious reasons. Comsat appropriately makes it in this court by way of defending the judgment. We reject it.

The United States Supreme Court has recently stated the following principles governing state taxation of a business engaged in interstate commerce: "The Due Process Clause of the Fourteenth Amendment imposes two requirements for such state taxation: a 'minimal connection' or 'nexus' between the interstate activities and the taxing State, and 'a rational relationship between the income attributed to the State and the intrastate values of the enterprise.' [Citations.] The tax cannot be 'out of all appropriate proportion to the business transacted by the . . . [taxpayer] . . . in that State.' [Citation.]" (*Exxon Corp. v. Wisconsin Dept. of Revenue* (1980) 447 U.S. 207, 219-220 [65 L.Ed.2d 66, 79, 100 S.Ct. 2109].) Comsat's maintenance of the California earth station at Jamesburg, and the office in Los Angeles County, satisfies the "nexus" requirement because Comsat has thereby availed itself of the " 'substantial privilege of carrying on business' within the State." (See *id.*, at p. 220 [65 L.Ed.2d at p. 220].) The second requirement has been satisfied because there

is " 'a rational relationship between the income attributed to the State and the intrastate values of the enterprise.' " (See *ibid.*)

We also consider a claim by Comsat, made for the first time on appeal, that the Board's application of the Uniform Act amounts to an unconstitutional burden on interstate commerce. This claim fails because it has not been shown that Comsat has been subjected to excessive and duplicative taxation, and that interstate commerce has thereby been discriminated against or otherwise impeded. (See *Exxon Corp. v. Wisconsin Dept. of Revenue, supra,* 447 U.S. 207 at pp. 227-230 [65 L.Ed.2d 66, 83-85]; *Moorman Mfg. Co. v. Bair* (1978) 437 U.S. 267, 276-281 [57 L.Ed.2d 197, 206-209, 98 S.Ct. 2340].)

The California Supreme Court has pointed out that the state has broad discretion in classifying property for purposes of taxation: ". . . A state tax law is not arbitrary although it 'discriminate[s] in favor of a certain class . . . if the discrimination is founded upon a reasonable distinction, or difference in state policy' . . . . [¶] . . . There exists no 'iron rule of equality, prohibiting the flexibility and variety that are appropriate' to schemes of taxation. [Citations.] So long as a system of taxation is supported by a rational basis, and is not palpably arbitrary, it will be upheld despite the absence of 'a precise, scientific uniformity of taxation.' [Citations.]" (*Amador Valley Joint Union High Sch. Dist. v. State Bd. of Equalization* (1978) 22 Cal.3d 208, 234 [149 Cal.Rptr. 239, 583 P.2d 1281].) Comsat is unique by its nature, and its unique character has been fairly taken into account in the special apportionment formula applied by the Board. It has not

been shown that the formula denies Comsat due process or equal protection of the laws. (See *Board of Medical Quality Assurance v. Superior Court* (1980) 114 Cal.App. 3d 272, 277 [170 Cal.Rptr. 468].)

Our independent review of the uncontradicted facts requires reversal of the judgment with directions as ordered below. (See *Pacific Motor Transport Co. v. State Bd. of Equalization* (1972) 28 Cal.App.3d 230, 243 [104 Cal.Rptr. 558]; 6 Witkin, Procedure, *op. cit. supra,* Appeal, §§ 546-547, pp. 4487-4489.)

The judgment is reversed. The cause is remanded to the trial court with directions to enter a judgment in favor of defendant and appellant Franchise Tax Board.

Caldecott, P. J., and Poché, J., concurred.

[The judgment of the Court of Appeal is set forth in the final paragraph of its opinion and is not separately entered in the records of the court.]

Appendix B

Superior Court of the State of California
for the City and County of San Francisco

No. 746 930

Communications Satellite Corporation
Plaintiff,

vs.

Franchise Tax Board,
Defendant.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

[Marked Filed by Court Clerk January 27, 1982]

This action came on for trial before the Court on June 9, 1981. The Court heard final arguments of counsel on August 3, 1981. The Court has considered the testimony of the witnesses, the exhibits introduced in evidence, the Stipulation of Facts entered into between the parties, the Briefs of the parties, and the arguments of counsel. The Court finds the following facts to be true (all references are to the applicable income years, 1970, 1971 and 1972, unless otherwise indicated):

1. The facts as stated in the Stipulation of Facts filed herein are established as true. The Court hereby incorporates the Stipulation of Facts into these Findings of Fact by reference as though fully set forth and finds each fact stipulated to be true.

2. Communications Satellite Corporation ("Comsat") has a headquarters, laboratory and research center in Washington, D.C.

3. The property factors computed by Comsat, expressed as percentages, were as follows:

Income Year	California Property	Total Property	Property Factor (%)
1970	$3,761,556	$132,933,655	2.8296
1971	4,141,436	162,639,643	2.5464
1972	4,495,716	203,298,615	2.2114

4. Comsat's net earnings are limited by regulation to a specified rate of return on its "rate base", i.e., the net book value of the property devoted to or used in its regulated business. Comsat's income is tied to its rate base. The statutory property factor, which is similar to (but not the same as) the regulatory rate base, reflects the proportion of the rate base property in California.

5. The property factors computed by Comsat are accurate. It is not true that the standard statutory property factor set forth in § 25129 of the Revenue and Taxation Code ("the Code") as computed by Comsat does not fairly represent the extent of Comsat's activity related to property in California, for each of the years in question.

6. The payroll factors computed by Comsat are accurate. It is not true that the standard statutory payroll factor set forth in § 25132 of the Code as computed by Comsat does not fairly represent the extent of Comsat's activity related to payroll in California, for each of the years in question.

7. In each of the years in question, Comsat computed the sales factor according to the fraction prescribed by Section 25134 of the Code and Regulation 25136(e)(2)(B). Comsat's computations were necessary to calculate the portion of its tariff revenues attributable to the California earth station.

8. The sales factors computed by Comsat, expressed as percentages, were as follows:

Income Year	California Sales	Total Sales	Sales Factor (%)
1970	$4,442,362	$104,737,032	4.2414
1971	3,707,712	123,186,481	3.0098
1972	4,267,174	142,053,550	3.0039

9. Comsat has a statutory monopoly in international satellite communications. Comsat conducts no marketing activities in California. The communications carried by Comsat's customers through Comsat's facilities originate at, and are destined for, ultimate users all over the United States and foreign countries. It is impossible for Comsat to determine the location of the ultimate users of communications circuits. There is no requirement that an earth station be located in California. Comsat could use its earth station at Brewster, Washington or a new one in any other Western state to handle all Pacific traffic and receive the same revenues from its customers. The sales factor should not reflect the location of an unusual concentration of purchasers or the existence of a special market in California for Comsat; neither has been shown to be present here. It should reflect only the fact that one of Comsat's Western earth stations is located in California.

10. Comsat is a capital-intensive business, requiring a dollar or more of investment to produce a dollar of sales. Comsat's figures for California property and California sales result in relationships of .85 of investment per dollar of sales for 1970, $1.12 of investment per dollar of sales for 1971, and $1.05 of investment per dollar of sales for 1972. Comsat's attribution of sales dollars to California, in relation to Comsat's property in California, is within the range of reasonable results.

11. The sales factors computed by Comsat are accurate. It is not true that the standard statutory sales factor set forth in § 25134 of the Code and Regulation 25136(e)(2)(B) as computed by Comsat does not fairly represent the extent of Comsat's activity related to sales in California, for each of the years in question.

12. The apportionment factors computed by Comsat are accurate. It is not true that the apportionment factors as computed by Comsat do not fairly represent the extent of Comsat's business activity in California, in each of the years in question.

13. The property factor employed by Franchise Tax Board ("the Board") to apportion Comsat's income differs from the property factor described in § 25129 of the Code in that it includes property not located within the state, namely, a portion of the taxpayer's interest in communications satellites located in outer space.

14. The sales factor employed by the Board to apportion Comsat's income differs from the sales factor described in section 25134 of the Code and Regulation 25136(e)(2)(B) in that it includes receipts from the rental or other use of tangible personal property located outside this state, namely, a portion of the receipts from the leasing of Intelsat circuits, and a portion of half-circuit rentals attributable to the use of satellites located in outer space.

15. On August 14, 1978, after an audit of the combined returns of Comsat and its subsidiaries for 1973, 1974 and 1975, the Board's audit supervisor sent Comsat schedules showing proposed adjustments to the property and sales factors. The property factor, as adjusted, again excluded

the value of Comsat's interest in the satellites from both the numerator and the denominator. The sales factor included in the numerator all revenues from half-circuits through the Jamesburg earth station, including the satellite portion.

16. On November 29, 1978, the Board notified Comsat that it was again changing the property factor; it would include in the denominator all of Comsat's operating property (including its interest in the satellites) but would also include in the numerator a portion of Comsat's interest in the satellites, based on the number of earth stations working with each satellite.

17. On January 4, 1979, the Board notified Comsat that it would instead determine the portion of Comsat's interest in the satellites to be included in the numerator of the property factor according to the ratio of circuits used in California to all circuits.

CONCLUSIONS OF LAW

The Court makes the following Conclusions of Law:

1. When the income of a taxpayer subject to the tax imposed under the Bank and Corporation Tax Law is derived from or attributable to sources both within and without the state, the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with Revenue & Taxation Code §§ 25120 - 25139.

2. All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator which is three.

3. The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible property owned or rented and used in this state during the income year and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the income year.

4. The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the income year by the taxpayer for compensation, and the denominator of which is the total compensation paid everywhere during the income year.

5. The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the income year, and the denominator of which is the total sales of the taxpayer everywhere during the income year.

6. Gross receipts from the rental, lease, licensing the use of or other use of tangible personal property shall be assigned to the state if the property is within this state during the entire period of rental, lease, license or other use. If the property is within and without the state during such period, gross receipts attributable to this state shall be based upon the ratio which the time the property was physically present or used in this state bears to the total time or use of the property everywhere during such period.

7. If the allocation and apportionment provisions of the Revenue & Taxation Code do not fairly represent the extent of the taxpayer's business activity in this state, the Franchise Tax Board may require, in respect to all or any part of the taxpayer's business activity, if reasonable, the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

8. The Franchise Tax Board bears the burden of proving that the standard statutory provisions do not fairly represent the extent of the taxpayer's activity in California before it may employ a special allocation and apportionment method. The Franchise Tax Board has not carried its burden of proof.

9. The purpose of the Uniform Division of Income for Tax Purposes Act (Revenue & Taxation Code §§ 25120-25139), as enacted in California, is to make uniform the laws of those states which enact it.

10. Courts, in interpreting statutes levying taxes, may not extend their provisions by implication beyond the clear import of the language used, nor enlarge upon their operation so as to embrace matters not specifically included. In case of doubt, construction is to favor the taxpayer rather than the government.

11. The income taxes determined and assessed to Comsat and collected by the Board in the amounts of $28,307.65, for the year 1970; $136,460.49, for the year 1971; and $151,576.76 for the year 1972; and the interest paid thereon, were illegally, erroneously and arbitrarily determined, assessed and collected by the Board, without factual basis for such determination, assessment and collection, and are void, for the reasons previously set forth in the Court's Findings of Fact herein.

12. Plaintiff shall have judgment against defendant as follows:

(a) In the sum of $316,345.10, representing taxes which were erroneously and illegally determined, assessed and collected by defendant, together with inter-

est thereon at the rate of 12% per year from April 1, 1977 until paid, in accordance with Revenue and Taxation Code Section 26107;

(b) In the additional sum of $109,865.57, representing interest paid by plaintiff on the taxes paid by plaintiff which were erroneously and illegally determined, assessed and collected by defendant, together with interest thereon at the rate of 12% per year, from April 1, 1977 until paid, in accordance with Revenue and Taxation Code Section 26107;

(c) In the additional sum of $1,240.54, representing interest due on $3,271.00 taxes overpaid for 1970, at the rates prescribed by law to April 1, 1977, together with interest on the sum of $3,271.00, at the rate of 12% per year, from April 1, 1977 until paid, in accordance with Revenue and Taxation Code Section 26107;

(d) For plaintiff's costs of suit herein, taxed at $ _____

Dated: January 27, 1982

/s/Donald B. King
Judge of the Superior Court

Superior Court of The State of California
For The City and County of San Francisco

No. 746 930

COMMUNICATIONS SATELLITE CORPORATION,
Plaintiff,

vs.

FRANCHISE TAX BOARD,
Defendant.

[Marked Filed by Court Clerk January 27, 1982]

JUDGMENT

This action came on for trial before the Court, sitting without a jury, on June 9, 1981. The Court heard final arguments of counsel on August 3, 1981. The Court has considered the testimony of the witnesses, the exhibits introduced in evidence, the Stipulation of Facts entered into between the parties, the Briefs of the parties, and the arguments of counsel. The Court has made and filed its Findings of Fact and Conclusions of Law. Now therefore, by reason of the foregoing:

IT IS HEREBY ORDERED, ADJUDGED AND DECREED THAT:

1. Plaintiff Communications Satellite Corporation shall recover judgment against defendant Franchise Tax Board in the sum of $316,345.10, representing taxes paid by plaintiff which were erroneously and illegally determined, assessed and collected by defendant, together with interest thereon at the rate of 12% per year, from April 1, 1977 until paid, in accordance with Revenue and Taxation Code Section 26107;

2. Plaintiff Communications Satellite Corporation shall further recover judgment against defendant Franchise Tax Board in the additional sum of $109,865.57, representing interest paid by plaintiff on the taxes paid by plaintiff which were erroneously and illegally determined, assessed and collected by defendant, together with interest thereon at the rate of 12% per year, from April 1, 1977 until paid, in accordance with Revenue and Taxation Code Section 26107;

3. Plaintiff Communications Satellite Corporation shall further recover judgment against defendant Franchise Tax Board in the additional sum of $1,240.54, representing interest due on $3,271.00 taxes overpaid for 1970, at the rates prescribed by law to April 1, 1977, together with interest on the sum of $3,271.00, at the rate of 12% per year, from April 1, 1977 until paid, in accordance with Revenue and Taxation Code Section 26107;

4. Plaintiff Communications Satellite Corporation shall have judgment against defendant Franchise Tax Board for plaintiff's costs of suit herein, taxed at $_____.

Dated: January 27, 1981

/s/ DONALD B. KING
Judge of the Superior Court

Appendix C

COMMUNICATIONS SATELLITE CORPORATION NON-ONE HUNDRED PERCENT OWNED SUBSIDIARIES AND AFFILIATES

1. Intelmet, a joint venture with Intercontinental Hotels Corporation;

2. Intercontinental de Communicaciones por Satelite (Intercomsa), a Panamanian Corporation;

3. Marisat Joint Venture, in which a wholly owned Comsat subsidiary is a partner with Western Union International, Inc., RCA Global Communications, Inc. and ITT World Communications, Inc.;

4. CHNCG, a joint venture between a wholly owned Comsat subsidiary and Holiday Inns, Inc.;

5. OxiProcessing, a partnership between a wholly owned Comsat subsidiary and Research Applications, Inc. (a subsidiary of Burlington Northern); and

6. TECMA, a Mexican corporation in which a wholly owned Comsat subsidiary is a shareholder.

Appendix D

Certified for Publication
In the Court of Appeal of the State of California
First Appellate District
Division Four
A016317
(Super. Ct. No. 746930)
Communications Satellite Corporation,
Plaintiff and Respondent,

v.

Franchise Tax Board,
Defendant and Appellant.

[Marked Filed by Court Clerk June 29, 1984]

ORDER MODIFYING OPINION AND DENYING REHEARING

THE COURT:

It is ordered that the opinion filed herein on May 31, 1984, be modified in the following particulars:

1. On page 40, the sentence on line 7 of the second full paragraph is deleted and the following sentence is inserted in its place:

> With two exceptions, we do not reach them.

2. On page 40, line 1 of the third full paragraph, the word "first" is to be inserted between the words "The" and "exception" so that the line reads:

> The first exception is a contention by Comsat that application of . . . .

3. On page 41, between the first full paragraph and the second full paragraph (enterprise.' " (See *Ibid.*) [¶] The

California Supreme Court has pointed out that the state. . . .) a new paragraph is to be added to read:

> We also consider a claim by Comsat, made for the first time on appeal, that the Board's application of the Uniform Act amounts to an unconstitutional burden on interstate commerce. This claim fails because it has not been shown that Comsat has been subjected to excessive and duplicative taxation, and that interstate commerce has thereby been discriminated against or otherwise impeded. (See *Exxon Corp. v. Wisconsin Dept. of Revenue, supra,* 447 U.S. 207 at pp. 227-230; *Moorman Mfg. Co. v. Bair* (1978) 437 U.S. 267, 276-281.)

The petition for rehearing is denied.

Poche, Acting P.J.

Appendix E

Order Denying Hearing

After Judgment by the Court of Appeal

1st District, Division 4, No. A016317

In the Supreme Court of the State of California

In Bank

Communications Satellite Corp.

v.

Franchise Tax Board

Respondent's petition for hearing DENIED.

(Marked Filed by Court Clerk August 29, 1984)

Bird
Chief Justice

Appendix F

Robert L. Dunn
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Attorneys for Plaintiff and Appellant
Communications Satellite Corporation

In the Court of Appeal
of the
State of California

First Appellate District

Division Four

1 Civil No. A016317

Communications Satellite Corporation,
Plaintiff and Appellant,

vs.

Franchise Tax Board,
Defendant and Respondent.

(Marked Filed by Court Clerk October 15, 1984)

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Communications Satellite Corporation, the Plaintiff and Appellant above-named, hereby appeals to the Supreme Court of the United States from the entire final judgment of the Court of Appeal of

the State of California entered in this action on May 31, 1984 (Petition for Rehearing denied by the Court of Appeal on June 29, 1984; Petition for Hearing denied by the Supreme Court of California on August 29, 1984), reversing the judgment of the Superior Court of the State of California, in and for the City and County of San Francisco.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

DATED: October 8, 1984.

Robert L. Dunn
Bancroft, Avery & McAlister

By: /s/Robert L. Dunn
Counsel for Plaintiff
and Appellant

Appendix G

CONSTITUTIONAL AND STATUTORY PROVISIONS

UNITED STATES CONSTITUTION

Art. 1, Section 8, Clause 3 ("the Commerce Clause") provides:

> The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several states, and with the Indian Tribes.

Amendment XIV, Section 1:

> [N]or shall any State deprive any person of life, liberty, or property, without due process of law, nor deny to any person within its jurisdiction the equal protection of the laws.

CALIFORNIA REVENUE AND TAXATION CODE

Section 25101: When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2. . . .

Section 25128: All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

Section 25129: The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the income year and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the income year.

Section 25134: The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the income year, and the denominator of which is the total sales of the taxpayer everywhere during the income year.

Section 25137: If the allocation and apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in the state, the taxpayer may petition for or the Franchise Tax Board may require, in respect to all or any part of the taxpayer's business, if reasonable:

(a) Separate accounting;

(b) The exclusion of any one or more of the factors;

(c) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.